

Management's Discussion and Analysis

The Washington State Treasurer's Office provides the Management's Discussion and Analysis of the Local Government Investment Pool's (LGIP) Comprehensive Annual Financial Report (CAFR) for readers of the financial statements. This overview and analysis of the LGIP's financial activity is for the Fiscal Year ended June 30, 2004. Please read this analysis in conjunction with the transmittal letter preceding this section and with the financial statements, which follow.

Financial Highlights

- The LGIP reported net assets as of June 30, 2004, in the amount of \$4.9 billion, a decrease over the previous year of approximately \$200 million.
- The LGIP distributed \$54 million to pool participants as a result of investment activity during the year. This was a decrease of \$20 million from the previous year.

Overview of the Financial Statements

The LGIP prepares its financial statements on an accrual basis in accordance with accounting principles generally accepted in the United States of America appropriate for investment companies. The Pool is operated in a manner consistent with Rule 2a-7 money market funds, as recognized by the Securities and Exchange Commission. These funds are limited to high quality obligations with limited maximum and average maturities in order to minimize both market and credit risk. Investments are reported on a trade date basis in accordance with GAAP. This report consists of a Statement of Net Assets, Statement of Operations, Statements of Changes in Net Assets, Notes to the Financial Statements, Schedule of Investments and Certificates of Deposit and the Schedule of Reconciliation of Assets. In addition, this report also contains supplementary and statistical information to aid the reader in further understanding the financial position of the LGIP and the results of its operation for the fiscal year ending June 30, 2004. The following is a description of the basic financial statements:

Statement of Net Assets - The statement of net assets presents all of the LGIP's assets and liabilities at fiscal year end. It also provides information on the types of investments held by the LGIP.

Statement of Operations - The statement of operations shows the revenues and expenses that were earned and/or generated during the year, with the difference reported as "net income". The net income is then distributed to the participants, based on their respective average balance in the fund.

Statements of Changes in Net Assets - All purchases and redemptions of investment units for the year are shown in the statement of changes in net assets, indicating the total activity of the participants in the fund.

Notes to Financial Statements - The notes to financial statements serve to describe the LGIP as a reporting entity and to further clarify its financial activity as reported in the financial statements.

Financial Analysis

In order to gain an understanding of the financial position of the LGIP, the reader should examine the financial statements as a whole, rather than in isolation from one another. This will help to provide a more comprehensive picture of the activity in the fund. We will begin by looking at the net assets of the pool. A summary of the LGIP's net assets is provided in the following table:

Net Assets

Table 1
Net Assets
(in millions)

	2004	2003	Dollar Change	Percent Change
Pooled cash and investments	\$5,392.7	\$5,374.1	\$18.6	0.3%
Receivables	4.7	4.5	0.2	4.4
Securities lending investments	298.8	143.9	154.9	107.6
Total Assets	5,696.2	5,522.5	173.7	3.1
Liabilities	748.7	343.8	404.9	117.7
Net Assets	\$4,947.5	\$5,178.7	\$(231.2)	(4.5)%

As the table shows, the LGIP experienced a decrease in net assets of \$231.2 million in 2004. Although both assets and liabilities experienced increases compared to last year, a large portion of this is due to securities lending and pending sales transactions, which have offsetting assets and liabilities entries. Because the LGIP is a 100% voluntary investment option for local governments and participants are free to utilize the LGIP at their discretion as they invest their funds, the percentage of total funds that individual participants have available for investment that are invested in the LGIP changes over time and can vary from near zero to 100%. Accordingly, the LGIP's Net Asset total is a function of several parameters, some of which are independent of the performance of the LGIP. The resulting change in net assets can best be explained simply by changes in deposits and withdrawals of the participants in the fund.

Changes in Net Assets

Table 2
Changes in Net Assets
(in millions)

	2004	2003	Dollar Change	Percent Change
Purchase of units	\$12,262.1	\$12,514.9	\$(252.8)	(2.0)%
Redemption of units	12,547.7	12,983.9	(436.2)	(3.4)
Net income distributed	54.4	73.7	(19.3)	(26.2)
Net increase (decrease) in net assets	\$(231.2)	\$(395.3)	\$164.1	41.5%

Net income for the LGIP was down by twenty-six percent over the previous year. This decline was due, in part, to the decrease in portfolio yield, as shown in Table 3. In addition, purchases decreased over the prior year and redemptions also decreased, which resulted in a net increase in net assets in the pool. Due to the discretionary nature of the LGIP as an investment option, it is difficult to ascertain the reasons behind the changes in net assets, as was discussed in the above paragraph on net assets.

Table 3
Average Monthly Portfolio Yield (360-Day Basis)

	2000	2001	2002	2003	2004
Portfolio Yield	5.56%	5.80%	2.58%	1.46%	1.05%
iMoneyNet Inc.	5.04%	5.27%	2.02%	1.05%	0.61%

The monthly portfolio yield represents the percent return of LGIP investments based on the average invested balance for the month. Table 3 shows an average of the monthly portfolio yields for each of the last five fiscal years. The average monthly portfolio yield showed a significant decline in Fiscal Year 2004 from previous years. The drop in LGIP yield can be explained by the decline in the targeted fed funds rate, which is the interest rate that banks charge each other for the use of funds. LGIP yields closely follow the targeted fed funds rate and this rate went from a high of 6.50% in the first half of Fiscal Year 2001, down to a low of 1.00% in June 2003, where it remained until the end of Fiscal Year 2004. The best measure of the LGIP's performance is not the change in the yield of the portfolio over time, but rather a comparison of the LGIP yield to the yield of its benchmark, iMoneyNet Inc., Government Only/Institutional Only Money Market Funds. This benchmark is comprised of privately managed money market funds similar in composition and guidelines to the LGIP. The LGIP net yield during Fiscal Year 2004 was 44 basis points higher than that of the benchmark. The LGIP continues to be a sound investment option for local governments, obtaining a competitive yield while preserving principal and liquidity.